

THE SECURITIES EXCHANGE ACT AS SUPPLEMENTARY OF THE SECURITIES ACT

JOHN HANNA*

The broad purpose of the Securities Act of 1933 is to protect the buyer of a newly issued security by requiring a fair disclosure of material facts and by penalizing the failure to furnish them in connection with the sale of the security through the use of the mails or of the instrumentalities of interstate commerce.¹ In addition, Section 17 of the Securities Act makes unlawful the use of the mails or the instrumentalities of interstate commerce to defraud buyers of securities whether newly issued or not.²

The Securities Act itself contains no provisions requiring issuers of securities registered under it to supply investors with current information about these securities. It is not concerned in any way with dealings in securities already issued nor, except to a limited extent, with dealings in securities issued in accordance with its provisions. It is obvious that many factors besides the information available at the time of registration may have a bearing upon the attractiveness of a security to a purchaser. The information provided in the registration statement becomes obsolete

* A.B., 1914, Dartmouth; A.M., 1915, Stanford; LL.B., 1918, Harvard. Professor of Law, Columbia University School of Law. Member of the Nebraska Bar. Counsel to the War Finance Corporation, 1919-1927; Special Counsel to the Farm Credit Administration, 1933. Reporter on Security, American Law Institute, 1936. Author: *Law of Coöperative Marketing Associations*, 1931; *Cases and Materials on Creditor's Rights*, 1931; *Cases and Other Materials on Security*, 1932. Contributor of articles to legal periodicals on the federal securities legislation and other topics.

¹ The Securities and Exchange Commission in its Second Annual Report states, at p. 1, the purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934 as follows:

"The purposes of the Securities Act of 1933 as outlined in the Report of the Committee on Banking and Currency are to prevent exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.

"The objectives sought in the passage of the Securities Exchange Act of 1934 were threefold, viz., to prevent the excessive use of credit to finance speculation in securities; to see to it that the market places in which securities are purchased and sold, such as the stock exchanges and the so-called over-the-counter markets, are purged of the abuses which had crept into them; and to make available to the average investor honest and reliable information sufficiently complete to acquaint him with the current business conditions of the company, the securities of which he may desire to buy or sell."

See Douglas and Bates, *The Federal Securities Act of 1933* (1933) 43 YALE L. J. 171; Tracy and MacChesney, *Securities Exchange Act of 1934* (1934) 32 MICH. L. REV. 1025.

² Section 17 is an important supplement to state blue-sky laws. See Smith, *State "Blue-Sky" Laws and the Federal Securities Act* (1936) 34 MICH. L. REV. 1135-1166.

in a comparatively brief period. Moreover, whatever the intrinsic merits of a security its desirability for the purpose of investment and speculation is affected by an actual and apparent demand for it. If the purchaser is induced to buy for \$200 a security fairly worth \$100 the effect upon his solvency may be substantially the same as if he bought for \$100 a security worth nothing. While the Securities Exchange Act of 1934 has other purposes, notably the regulation of credit used in security dealings, one of its primary objects is to supplement the protection given the investor by the Securities Act.³

The Securities Exchange Act of 1934 supplements the Security Act in two principal ways:⁴ (1) It makes available reliable information about the current business conditions of the issuers of what are on the whole the most important securities bought and sold in the United States;⁵ (2) It prohibits practices tending to create fictitious values for securities and gives the Securities and Exchange Commission broad powers over the trading in securities.

³The editor of this symposium has requested as the conclusion of this symposium a brief statement of the extent to which the Securities and Exchange Act confirms and supplements the Securities Act. No attempt is here made to indicate various differences of detail between corresponding sections of the two acts or to discuss purposes of the Exchange Act which have no direct bearing on the purposes of the Securities Act. These can be left appropriately to more comprehensive discussions of the Exchange Act.

⁴The Securities Exchange Act of 1934 included as a rider significant amendments to the Securities Act of 1933. These amendments are not dealt with here. They have been mentioned in other articles in this symposium and are here mentioned as a part of the Securities Act rather than of the Securities Exchange Act. See Hanna, *The Securities Exchange Act of 1934* (1934) 23 CALIF. L. REV. 1.

⁵The importance ascribed to the features of the Act carrying forward the publicity features of the Securities Act is shown in the following extract from H. R. REP. NO. 1363, 73d Cong., 2d Sess., quoted from C. C. H., STOCK EXCHANGE REGULATION SERVICE, par. 2105.02, pp. 1016-1018: "No investor, no speculator, can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy. The disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values, truth does find relatively quick acceptance on the market. That is why in many cases it is so carefully guarded. Delayed, inaccurate, and misleading reports are the tools of the unconscionable market operator and the recreant corporate official who speculate on inside information. Despite the tug of conflicting interests and the influence of powerful groups, responsible officials of the leading exchanges have unqualifiedly recognized in theory at least the vital importance of true and accurate corporate reporting as an essential cog in the proper functioning of the public exchanges. Their efforts to bring about more adequate and prompt publicity have been handicapped by the lack of legal power and by the failure of certain banking and business groups to appreciate that a business that gathers its capital from the investing public has not the same right to secrecy as a small privately owned and managed business. It is only a few decades since men believed that the disclosure of a balance sheet was a disclosure of a trade secret. Today few people would admit the right of any company to solicit public funds without the disclosure of a balance sheet. . . ."

"The reporting provisions of the proposed legislation are a very modest beginning to afford that long-denied aid to the exchanges in the way of securing proper information for the investor. The provisions carefully guard against the disclosure of trade secrets or processes. But the idea that a fair report of corporate assets and profits gives unfair advantage to competitors is no longer seriously entertained by any modern business man. The realistic corporate executive knows that his alert competitors have a pretty good notion of what his business is and if he is unable to compete with them it is because he is hope-

I

The more ardent believers in public control of business favor giving governmental agencies a comprehensive control over all phases of investment and speculation. Considerable progress has been made in that direction by the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934. The responsibilities of the Securities and Exchange Commission and of the Federal Reserve Board under that Act are too varied to be discussed within the bounds of a single article. Since what is here attempted is a statement of the extent in which the Exchange Act supplements the purposes of the Securities Act, most of this discussion must be directed to the publicity features of the Exchange Act.

Prior to the passage of the Exchange Act the investor and speculator in corporate securities found his chief protection in the listing requirements of the New York Stock Exchange. Some corporations, notably the United States Steel Corporation, were generous in their disclosures to stockholders and the general public. Many corporations, however, regarded figures about corporate business as the property of insiders, and gave out as little information as possible.

Listing requirements on stock exchanges have for their purpose not only a certain assurance of the genuineness of the securities listed and of a free and open market, but also the providing of relevant information about the securities and the issuers. The New York Stock Exchange, occasionally with the sharp opposition of corporation executives, accomplished much to make corporate information available to the public. Listing requirements have become progressively more rigorous in recent years. At the time of the Senate investigation of the Stock Exchange in 1932, the Stock Exchange required an application for listing to be presented to the Exchange for consideration by the Committee on Stock List.⁶ The application was required to state much detailed information about the issuer, its capitalization, the privileges accruing to its various security issues, its subsidiary and controlled companies, its property and current business and to be accompanied by financial statements, including balance sheets and income accounts. Copies of charters and other documents, mostly bearing directly upon the listing application, were required to be filed with the application but in general the requirements of the filing of copies

lessly behind in the keen competitive struggle. The reporting provisions of the legislation have been approved by such conservative investment services as Moody's and Standard Statistics and, despite the wild fears spread throughout the country by powerful lobbyists against this bill, intelligent business men recognize that general knowledge of business facts will only help and cannot hurt them. The possession of these facts has for a number of years been the exclusive perquisite of powerful banking and industrial groups. Making these facts generally available will be of material benefit and guidance to business as a whole."

⁶The New York Stock Exchange listing requirements in 1932 may be found in Exhibit No. 28, p. 76 *et seq.*, Appendix to Parts 1, 2, 3, U. S. Senate. Banking and Currency Committee, Hearings on Stock Exchange Practices, S. RES. 84, 72d Congress, 1st Sess. See, for a general discussion of New York Stock Exchange listing requirements, TWENTIETH CENTURY FUND, INC., THE SECURITY MARKETS (1935) 235-237, 592-609. The stock listing requirements of all the national securities exchanges are found in the Supplement to the C. C. H., STOCK EXCHANGE REGULATION SERVICE. The New York Stock Exchange requirements are set out in pp. 8215-8235.

of documents were much less severe than under either the Securities Act or the Exchange Act.

A most important part of the application for stock listing consisted in a number of agreements which had to be made with the Exchange as a condition of listing. These agreements, among others, were to notify the Exchange of changes in the nature of the business of the issuer, to furnish annual balance sheets and income statements to stockholders, and to publish periodical reports of earnings as agreed with the Stock List Committee. These agreements were numerous and detailed and resulted in a great improvement in the amount and nature of the information available to stockholders. Since 1934 the Stock Exchange has definitely required that financial statements contained in annual reports of corporations shall be audited by independent public accountants and shall be accompanied by the certificate of the accountants. The Exchange, so far as it deems it feasible, requires quarterly earnings reports. Some of the stock listing requirements have been adopted since certain securities were listed, but the Exchange endeavors so far as possible to induce issuers of listed securities to comply with later policies even when the issuers are not bound by agreement to do so.

The Committee on the Stock List has also worked informally, both in cooperation with the American Institute of Accountants and otherwise, for the improvement of corporate reports. For example, corporations have been urged to distinguish between capital and earned surplus and to disclose the nature of "other income" where such an item appears in an earnings report.

The Exchange Act in its registration requirements for securities that are the subject of trading on national securities exchanges provides a supplement and not a substitution for the listing rules of the exchanges. National securities exchanges themselves must be registered as a result of the prohibition in Section 5 of the use of the mails or of the instrumentalities of interstate commerce by a dealer, broker, or exchange for the purpose of employing the facilities of a national securities exchange unless the exchange is registered. Section 6 provides for the registration of exchanges. Section 12 requires registration of securities listed on exchanges or admitted to unlisted trading privileges.⁷ Section 13 provides for periodical and other reports designed to keep reasonably current information provided by registration under Section 12.⁸ The sections requiring registration of securities and periodical

⁷ The Commission has prescribed in its Forms 10 and 23, inclusive, forms of application for permanent registration of securities by various types of issuers.

⁸ Section 13 is potentially one of the most significant sections of the Act, particularly in respect to its effect on the individual investor. The registrants under Section 12 are by Section 13 required to keep current the information and documents filed under Section 12, to furnish annual reports, and if the Commission so requires, quarterly reports as well, and to conform to the Commission's directions as to form and contents of reports, and even as to accounting methods. The Commission has prescribed the form of annual reports in its Forms 10K to 21K, inclusive, Securities Exchange Act Release No. 1005, Jan. 6, 1937. See, as to current reports, S. E. C. Rule KA7, adopted in Securities Exchange Act Release No. 925, effective November 11, 1936.

Annual reports must be filed not more than one hundred and twenty days after the close of each fiscal year. Special forms are provided relating to securities of fixed investment trusts, voting trust

reports are supplemented by Section 16. This section imposes upon a beneficial owner of more than ten per cent of any class of a registered equity security and upon each director and officer the obligation to file a statement of his holdings and report any changes at the end of each calendar month. If any such person buys an equity security and sells it within six months at a profit, or sells or buys it back at a profit within six months, the issuer may recover the profit. Short sales by officers, directors and ten-per-cent stockholders are forbidden. The purpose of the section is to prevent insiders from profiting by dealings in securities on the basis of information not available generally to the stockholders. The provisions regarding officers, directors and ten-per-cent stockholders, while easy enough to apply in normal situations, present difficult problems of both interpretation and application in the intricate variety of circumstances in which security dealings actually occur.⁹

The procedure for registration of a security is for the issuer to file an application to an exchange and to file such duplicate originals with the Commission as the latter may require, covering such information as the Commission may stipulate in respect to items listed in Section 12(b). These items are as follows:

- (A) the organization, financial structure and nature of the business;
- (B) the terms, position, rights, and privileges of the different classes of securities outstanding;
- (C) the terms on which their securities are to be, and during the preceding three years have been, offered to the public or otherwise;
- (D) the directors, officers, and underwriters, and each security holder of record holding more than 10 per centum of any class of any equity security of the issuer (other than an exempted security), their remuneration and their interests in the securities of, and their material contracts with, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer;
- (E) remuneration to others than directors and officers exceeding \$20,000 per annum;
- (F) bonus and profit-sharing arrangements;
- (G) management and service contracts;

certificates, and certificates of deposit issued by a committee. C. C. H., STOCK EXCHANGE REGULATION SERVICE, par. 8530, p. 6526.

Current reports must be filed in the first ten days of the month following the month in which occurs one of the following events:

1. Material amendments of exhibits previously filed.
2. The execution of new voting trust agreements and certain other instruments.
3. Substantial restatements of the capital shares account.
4. The issuance of any new class of securities, or an increase or decrease of more than 5% in the amount of any class of securities outstanding.
5. Under certain circumstances, the granting by the registrant of options to purchase any of its equity securities, or the extension or exercise of such options.
6. A person's becoming or ceasing to be a parent or subsidiary of the registrant.
7. Substantial revaluation of the registrant's assets.
8. Substantial withdrawals or substitutions of property securing any registered securities."

C. C. H., STOCK EXCHANGE REGULATION SERVICE, par. 8519, p. 6516.

The Commission has prescribed two Uniform Systems of Accounts, one for Public Utility Holding Companies, and one for Mutual Service Companies and Subsidiary Service Companies. The regulations prescribing these systems were issued, however, not under §13 of the Exchange Act, but under §13 of Public Utility Holding Company Act of 1935.

⁹ See Seligman, *Problems Under the Securities Exchange Act* (1934) 21 VA. L. REV. 1.

- (H) options existing or to be created in respect of their securities;
- (I) balance sheets for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants;
- (J) profit and loss statements for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants; and
- (K) any further financial statements which the Commission may deem necessary or appropriate for the protection of investors.

The issuer must also file such copies of articles of incorporation, by-laws, trust indentures, underwriting arrangements, voting trust agreements and other similar documents, as the Commission may require as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security.

It is a condition of registration that the exchange authorities certify to the Commission that the security has been approved by the exchange for listing and registration. Registration becomes effective thirty days after the receipt of such certification by the Commission or in such shorter time as the Commission may determine. The registration requirements of Section 12 are generally similar to the registration requirements of the Securities Act as set forth in Schedule A. Both registration requirements may be modified or especially may be enlarged by the Commission. Schedule A, however, contains more detailed provisions relating to underwriters and promoters.¹⁰ It also requires the filing of copies of such documents as indentures, whereas copies of such documents need be filed under the Exchange Act only if the Commission determines they should be filed in the public interest.¹¹ Both registration statements differ from the usual stock exchange listing requirements in their demand for disclosure of the stock interest and remuneration of officers, directors, ten per cent stockholders and others. On this item the Exchange Act is more drastic than the Securities Act. Under the former the officers, directors and ten per cent stockholders must be named and their remuneration stated, as well as the remuneration of others if more than \$20,000 a year.¹² Under the Securities Act, the remuneration to officers and other persons, except directors, may be stated without allocation to individuals unless they receive an annual compensation of \$25,000 or more.¹³

Exemptions from registration under the Exchange Act are somewhat narrower than under the Securities Act. Some securities such as insurance policies, receivers' certificates and securities of building and loan associations, which need not be registered under the Securities Act, are not included as exempt under the Exchange Act, perhaps because they are not likely to be listed on an exchange. Reorganization securities and securities of interstate common carriers, subject to Section 20 of the Interstate Commerce Act, are exempt from registration under the Securities Act but must be registered under the Exchange Act, presumably because of the continuing

¹⁰ Securities Act, Sched. A, (6), (10), (17), (18), (20), (21), (22).

¹¹ *Id.*, Sched. A, (28), (30), (31), (32).

¹² Securities Exchange Act, § 12(b)(1)(D)(E); § 13.

¹³ Securities Act, Sched. A (14). -

publicity features of the latter Act. The principal exempt securities under both Acts are the bonds of the United States, the states and their subdivisions.¹⁴ It is rather surprising that under the Securities Act but not under the Exchange Act, certificates of deposit for exempt securities are not exempt from registration. Because of the size of the administrative problem confronting the Commission, the Act in effect granted to listed securities a temporary exemption from registration by providing that the Commission was authorized to permit securities listed on an exchange at the time the registration of the exchange became effective to be registered until July 1, 1935 without complying with the registration requirements of Section 12. The Commission duly allowed the period of grace. In accordance with the provisions of the Act the full registration requirements are now in effect.

If a corporation has registered a security under the Securities Act it should have little difficulty in complying with listing and registration requirements under the Exchange Act. The collection and arrangement of information in the form required by the Commission will also facilitate the preparation of annual and periodical reports. Similarly if a going concern, which has registered its securities under the Exchange Act or has published the annual or periodical reports in the form approved by the Commission, wishes to register a new security issue under the Securities Act, its counsel, accountants and officers will find themselves with considerable material for the preparation of the new documents. The somewhat greater severity of the registration requirements under the Securities Act and the tendency of the Commission and its staff to scrutinize applications for registration under the Securities Act somewhat more carefully than applications under the Exchange Act, indicates that the corporation which has successfully registered a security under the Securities Act, is somewhat better prepared for subsequent dealings with the Commission than one which has merely registered a security on a national securities exchange. It seems, however, that such differences are likely to diminish rather than to increase.

The Commission in administering the Exchange Act has an opportunity to enable it to obtain information which may afford a basis for proceedings to enforce compliance with the Securities Act. An interesting instance of this procedure is found in connection with a recent issue of bonds of the Brooklyn Manhattan Transit Corporation.¹⁵ In 1934 these bonds were sold to four investment banking houses. No registration statement was filed under the Securities Act. The bonds were duly listed on the New York Stock Exchange. The investment bankers then resold the bonds. The Corporation applied for registration of these bonds under the Exchange Act. The Commission refused to allow the registration pending a hearing, which was held October 3 and 4, 1934. The Commission's inquiries disclosed that at least \$524,000 principal amount of the bonds were carried through the mails or in interstate commerce between June 11, 1934, the earliest delivery date of the bonds, and September 15, 1934. The Commission also regarded the four investment banking

¹⁴ *Id.*, §3(a); Securities Exchange Act, §3(a).

¹⁵ Securities Exchange Act Release No. 261, June 6, 1935, with opinion dated June 4, 1935.

houses as underwriters within the terms of the Securities Act. The Commission took the position that the bonds should have been registered under the Securities Act and that, since this registration had not occurred, they were not entitled to registration under the Exchange Act and in consequence not entitled to trading privileges on a national securities exchange. The Commission thus held that it might refuse to make available the facilities of national securities exchanges to securities which should have been, and were not, registered under the Securities Act. In the actual case the Corporation, upon learning the attitude of the Commission, registered the bonds under the Securities Act, and when this registration became effective the Commission also allowed registration under the Exchange Act and the bonds were restored to trading privileges on the New York Stock Exchange.

In addition to listed securities it has been the practice of exchanges to permit trading in certain unlisted securities. The Exchange Act as originally passed allowed the Commission to continue until June 1, 1936 unlisted trading privileges to securities which had such privileges on any exchange prior to March 1, 1934.¹⁶ An amendment passed in 1936,¹⁷ allows an exchange, subject to the Commission's regulations, to continue unlisted privileges to those securities enjoying the privilege prior to March 1, 1934, to those listed on other exchanges and to other securities, where the issuer has filed with the Commission registration statements and periodic reports. It is provided further that any security granted unlisted trading privileges is to be deemed registered on a national securities exchange and thus subject to the laws and regulations applicable to registered securities and their issuers.

Besides the securities in the listed and unlisted trading departments of the national securities exchanges, and the securities of small corporations in which no particular market is maintained, other securities of considerable importance are the subject of trading in what is known as the over-the-counter market. It is the practice for some brokerage or investment house to announce itself as making a market for certain securities not dealt in on the exchanges. It gathers lists of persons who are likely to wish to buy or sell these securities. The financial community understands that purchases and sales of certain stocks and bonds may most conveniently be made through certain houses. These houses also are generally ready to quote bid and asked prices. The Exchange Act recognizes that if it applied only to trading on exchanges, the over-the-counter market might afford an opportunity for evading the law. The Exchange Act originally made no attempt to prescribe rules for the regulation of over-the-counter markets, merely giving the Commission in Section 15 broad regulatory authority and a direction for study and report. In 1936 following the Commission's report and recommendation Section 5 was amended and amplified.¹⁸

¹⁶ Securities Exchange Act, §12(f).

¹⁷ Pub. No. 621, 74th Cong. 2d Sess., approved May 27, 1936.

¹⁸ *Ibid.* The registration requirements were effective August 26, 1936. Besides §§12 and 15, the Act also amended in minor particulars Sections 17(a), 18(a), 20(c), 21(f) and 32.

The Exchange Act now requires all brokers and dealers except those effecting transactions solely on registered exchanges, to be registered with the Commission, unless their business is exclusively intrastate or restricted to trading in exempt securities or commercial paper.¹⁹ Since the Commission has the broadest power to determine the information it may require from brokers, it is obvious that the Commission can thus obtain perhaps all the information it needs about the securities for which the registrant may be making a market. The new section also contains the definite stipulation²⁰ that every registration statement under the Securities Act, filed more than 90 days after May 27, 1936, shall contain an undertaking by the issuer to file with the Commission such supplementary information and periodic reports as the Commission may require from issuers of securities registered on a national securities exchange. Such an undertaking becomes operative only if the aggregate offering price of the issue of securities is \$2,000,000 or more. The duty assumed by this undertaking is suspended if such security or any other security of the issuer is registered on a national securities exchange so that it automatically becomes subject to the duties imposed upon issuers of registered securities. The duty is also suspended if the aggregate value of all outstanding securities of the class to which such issue belongs is reduced to less than \$1,000,000.

Section 11 of the Securities Act imposes civil liabilities for material inaccuracies or material omissions in a registration statement. Until the Securities Act was amended by the rider attached to the Exchange Act of 1934, liability under Section 11 was based on a theory of rescission with the abolition of the requirement of privity. Under the original act there was no burden on a plaintiff to prove reliance, causation and scienter. The few defenses available to the many categories of persons upon whom civil liability was imposed by the Securities Act, included failure to establish that the statement in question was untrue, that it related to opinion and not fact, and that it was immaterial.²¹

Since 1934, Section 11 is not founded on a rescission theory. The plaintiff must now show that he has relied on the misstatement provided that before the plaintiff acquired the security, the issuer published an earnings statement covering at least twelve months after the effective date of the registration statement. Reliance may be proved, however, without proof that the plaintiff read the registration statement. Another change made by the 1934 amendments was to allow the defendant to show a lack of causal connection between the untruth and the plaintiff's loss. Finally this amendment established definite rules for the measurement of damages. The suit "may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought

¹⁹ The form of the requirement is a prohibition of the use of the mails or the instrumentalities of interstate commerce to effect certain transactions in securities.

²⁰ Securities Exchange Act, §15(d), as amended by Pub. No. 621, *supra* note 17.

²¹ Comment, *Civil Liability for Misstatements in Documents Filed Under Securities Act and Securities Exchange Act* (1935) 44 YALE L. J. 456.

or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof at the time such suit was brought."

Even as amended, the civil liability provisions of the Securities Act remain more rigorous than those of the Exchange Act. Civil liability under the latter may arise from misleading statements in a variety of documents. These include registration statements for securities, periodical reports by issuers of such securities, statements filed by directors, officers or ten per cent stockholders and documents which the Commission may require in connection with unlisted securities or securities on over-the-counter markets. A cause of action is given by Section 18(a) against "any person who shall make or cause to be made any statements in any application, report or document filed "under the Act or its regulations, if the statement was "at the time and in the light of the circumstances false and misleading with respect to any material fact." This liability is in favor of "any person (not knowing that such statement was false or misleading) who in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement." The defense is open to the person sued that he acted in good faith and had no knowledge that such statement was false or misleading. It will be noted that contrary to the provisions in Section 11 of the Securities Act the plaintiff must prove that he relied on the misstatement without any exception from this requirement during a period immediately after the publication of the untrue statement. Some persons have argued that the Act in requiring reliance is unduly generous to those responsible for misleading statements. Such statements may influence investment services and other advisers to such an extent as may affect the market and so cause injury to buyers or sellers who are themselves unaware of the misleading statements.

The Exchange Act, it will be noted, omits the specific provision of the Securities Act that reliance may be shown without proof that the plaintiff read the statement. This omission does not mean necessarily that proof of reliance requires proof of reading, but the omission may nevertheless render somewhat more difficult the maintenance of suits under Section 18. An apparent consequence of the reliance requirement is that if the plaintiff has purchased before the misstatement and has sold because of his own financial difficulties, he may not recover his loss on a security even if its decline in price was due to a misstatement in a document filed with the Commission.

The Exchange Act contains no rules for the measurement of damages. Whether the measure of damages provided in the Securities Act will be used or a common law measure of damages is still undetermined. Since some issuers of securities frequently must file documents under both the Securities Act and the Exchange

Act, an investor injured by a misstatement in two registration statements might have the option to sue under either act, and if the misstatements could be said to have caused different losses he might be allowed to sue under both acts. The Exchange Act, unlike the Securities Act, does not limit damages to the sum at which the security was offered to the public. Under the Securities Act an injured person might recover part of his loss, and obtain the balance as the result of a suit under the Exchange Act.

II

The investor or speculator may not only suffer from the lack or inaccuracy of information, which may enable him to form a judgment of the intrinsic merits of securities, but may also be deceived as to relative values of securities by misleading impressions gained from the volume of transactions or the upward or downward tendencies of prices. Too great facilities for speculation may tempt the unwary into unwise commitments in circumstances where minor fluctuations of prices may cause him irremediable damage. So far as security trading concerns the larger aspects of credit and financial policy, the Exchange Act invests the Federal Reserve Board rather than the Securities and Exchange Commission with administrative authority. Section 7, for example, dealing with margin requirements, is administered by the Federal Reserve Board and Section 8, dealing with broker's borrowing, is largely, but not exclusively, administered by the Board. These sections, although designed primarily to safeguard the nation's banking structure, do afford considerable protection to traders in securities. Not the least of this protection is a protection to the traders from themselves.

The Exchange Act in Section 5 forbids brokers, dealers and exchanges from using the mails or the instrumentalities of interstate commerce in employing the facilities of any exchange not registered as a national securities exchange, unless it is excepted by the Commission. Section 6, as has been mentioned, provides for the registration of national securities exchanges. The Commission is given broad powers of prescribing the information it desires from exchanges. Section 11 gives the Commission power to regulate and prescribe the functions of the members of the exchanges, to regulate or prevent floor trading, and prevent excessive trading by members, and to regulate odd lot dealers and specialists. A member who is a broker and dealer of a securities exchange may not carry for his customers on margin directly or indirectly a security which was part of a new issue in the distribution of which he participated as a member of a selling syndicate within six months. Likewise, a broker who is also a dealer may not make a purchase or sale for or with a customer unless he discloses to the customer in writing at or before the completion of the transaction, the capacity in which he is acting. The general purpose of all these provisions is to assure to the investor and trader in securities as reliable information as possible about market conditions, as well as a convenient, accessible and honestly conducted market.

Section 9 forbids any person by the use of the mails or any instrumentality of interstate commerce to employ the facilities of any national securities exchange to create artificial prices. Wash sales, matched orders, rigging the market, dissemination of information about market activity for the purpose of affecting the price of securities, and the issuance of false and misleading statements regarding securities are categorically prohibited. Pegging or stabilizing prices, puts, calls, straddles and other options are unlawful except to the extent permitted by the regulations of the Commission.

Section 10 forbids short sales or stop loss orders of securities registered on a national security exchange except as such transactions are allowed under the Commission's regulations. In addition Section 10 contains a blanket provision forbidding any manipulative or deceptive devices in contravention of the rules and regulations of the Commission. The resourceful and unscrupulous traders who think up schemes not specifically condemned by Section 9 thus find themselves at best only one jump ahead of the Commission.²²

III

The Exchange Act in addition to Section 11, imposing civil liability for misleading statements in registration statements, periodical reports and other documents, contains numerous provisions designed to prevent violations and to give redress to parties ignored by such violations. The Commission upon complaint or on its own initiative may investigate possible violations of the Act,²³ may conduct inquiries at which it can compel the attendance of witnesses,²⁴ may sue to enjoin threatened violations,²⁵ may bring mandamus to compel compliance,²⁶ may suspend or withdraw licenses to exchanges,²⁷ may alter the rules of exchanges,²⁸ and may for brief periods suspend trading in registered securities.²⁹

Wilful violation of the provisions of the Act or of rules properly issued thereunder is made a crime.³⁰ A person who wilfully engages in manipulative practices is made liable for damages to any person purchasing or selling a security at a price which was influenced by manipulative practices.³¹ A person who controls another is made jointly and severally liable to the same extent as the controlled person, unless the controlling person acts in good faith.³² Contracts in violation of the Act are void as are contracts binding any person to waive compliance with the Act or rules and regulations issued under it.³³

²² See Mathias, *Manipulative Practices and the Securities Exchange Act* (1936) 3 UNIV. OF PITTSBURGH L. REV. 7, 105; TWENTIETH CENTURY FUND, INC., *THE SECURITY MARKETS* (1935) 444.

²³ Securities Exchange Act, §21(a). See Comment, *Investigatory Powers of the Securities and Exchange Commission* (1935) 44 YALE L. J. 819.

²⁴ Securities Exchange Act, §21(b), (c), (d).

²⁵ *Id.*, §21(e).

²⁶ *Id.*, §21(f).

²⁷ *Id.*, §19(a), (b).

²⁸ *Id.*, §19(b).

²⁹ *Id.*, §19(a)(4).

³⁰ *Id.*, §32. See Herlands, *Criminal Law Aspects of the Securities Exchange Act* (1935) 21 VA. L. REV. 139.

³¹ Securities Exchange Act, §19(c).

³² *Id.*, §20.

³³ *Id.*, §29.

From this brief outline it is perhaps apparent that, admitting the desirability of the Securities Act, it is nonetheless essential that it be supplemented in important particulars by the Exchange Act. It might be preferable indeed if many of the features of both acts were a part of one statute instead of two. Certain inconsistencies between the two acts remain to irritate those subject to them and to complicate the task of the Commission. To some extent the Commission is eliminating those by its regulations; as to others the Commission will doubtless in the future be able to suggest clarifying changes. While not all that the Commission has done has met with universal approbation it has thus far exhibited, at least in matters primarily affecting the protection to investors, an attitude of continuous watchfulness after the investor's interests that has accumulated for it considerable assets of public good will. Few will be bold enough to regard the Securities Act and the Exchange Act as temporary or to look upon the Commission as anything but a permanent factor in the financial community.³⁴

³⁴ Critics of both the Securities Act and the Securities Exchange Act argue that these Acts and the Commission's regulations under them require the filing at great cost and inconvenience of statements and reports so detailed and extensive that no investor may be expected to make any examination of them and that few investors could comprehend them even if examined. While the Commission may keep certain information secret, most of the reports to it are available to the public, either to examine or by obtaining copies of filed documents by paying the cost of duplication. The ordinary investor relies upon the advice of investment services whose experts are presumably competent to analyze even the reports filed with the Commission. A considerable number of the items found in filed documents, especially when these are summarized in the Commission's press releases and reports, find their way into the financial columns of daily and other newspapers, and provide even the casual investors with much usable information. It is quite possible, however, that a considerable simplification of the Commission's requirements might occur without materially decreasing the protection now enjoyed by the public. The Commission's tendency at the moment is to increase, rather than diminish, its authority over trades and trading practices. There is no real evidence that public opinion yet desires a lessening of the Commission's activities.